DEC 19 1957
JOHN J. [illegible], Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1957.

No. 675

RAYMOND S. MILLER and JOSEPHINE MILLER,

and

FRANK NOWATZKI and LILLIAN NOWATZKI,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Raymond S. Miller, Josephine Miller, Frank Nowatzki and Lillian Nowatzki, petitioners, pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit, entered in cases which were consolidated.

Judgment was entered by the United States Court of Appeals for the Seventh Circuit on July 9, 1957. Petition for rehearing, which was filed by petitioners in said United States Court of Appeals, was denied on September 20, 1957.

OPINION BELOW.

The opinion of the United States Court of Appeals for the Seventh Circuit is reported at 247 Fed. 2d 206.

JURISDICTION.

Filed with the petition is a duly certified copy of record, which includes a copy of the judgment. The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1).

QUESTIONS PRESENTED.

1. Whether a dividend declared payable to shareholders on the day preceding the date of declaration could be found to be income, for purposes of income tax, of parties who entered into an executory contract to buy the shares on the date of the declaration of the dividend?

2. Whether the dividend declared on shares of stock when the shares of stock were the subject of an executory contract of sale, subject to a condition precedent, could be considered income to petitioners who subsequently acquired the shares of stock?

STATUTE INVOLVED.

The statute which is involved is 28 U. S. C. (I.R.C. 1939) Sec. 22 (a).[1] In that statute it is stated that gross income includes dividends.

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[1] **Sec. 22. Gross Income.**

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

STATEMENT.

On July 29, 1950, one Clarence W. Miller was the owner of 45,500 of the 46,700 outstanding shares of Tiny Tot Safety Table Co.

On that date, an agreement was entered into by and between Clarence W. Miller as Seller; Raymond S. Miller and Frank Nowatzki as Buyers; and Tiny Tot Safety Table Co., an Illinois corporation, as the corporation. That agreement is set forth on page 15 of the joint appendix filed in the United States Court of Appeals. Form of collateral note, which was to be executed later, was attached to said agreement. This form of collateral note is shown on page 20 of said joint appendix.

The Seller and the Buyers signed said agreement. Then, on the same day, the Board of Directors of the corporation, which was controlled by the Seller, met on a waiver of notice. They authorized execution of the agreement by the corporation and, having then determined that there was a substantial earned surplus, they declared an ordinary dividend of 58¢ a share on the outstanding shares, payable to stockholders of record on July 28, 1950. Minutes of said Board of Directors appear on page 23 of said joint appendix. Thereafter, the agreement was executed by the corporation.

Dividend was paid to the Seller as evidenced by checks reproduced on pages 27 and 28 of said joint appendix.

In the agreement it was provided that as a condition precedent to the contract becoming effective the Seller and the Corporation had to furnish the Buyers with a certified balance sheet, made by the Auditor of the Corporation, as of the close of business on July 31, 1950. The Seller retained full control of the stock, of the Board

of Directors and of the Corporation until after the end of July, 1950.

The Buyers of the stock were present when the Board of Directors declared the dividend. They approved the minutes because they believed these minutes showed intentions of the parties that Seller would be subject to income tax on the dividend, for identification purposes and so that no other minutes could be substituted.

At the time of the declaration of the dividend, there had been no assignment or escrow of the stock, nor had a trust been created. At that time, Seller was in complete control of the stock, of the Board of Directors and of the corporation.

While papers were drawn in the present tense, the transaction was not completed until August 4, 1950, when the stock was transferred, as evidenced by assignment reproduced in joint appendix at page 29. Thereafter, Buyers reassigned the stock as collateral, and executed a collateral note.

Seller could not sue on the agreement until the condition precedent was performed or waived. Buyers could not sue the corporation for the dividend.

REASONS FOR GRANTING THE WRIT.

The decision below should be reviewed because it is a decision in conflict with decisions in the same and other circuits as to when a dividend vests in a shareholder.

In *Bowers* v. *Post* (Dist. Ct. N. D. Ill. E. D. 1913) 209 F. 660, it was held that one who was a stockholder at the time of the adoption of a resolution providing for a stock dividend to holders of original stock, but subsequently transferred his stock, was entitled to retain divi-

dends. The Court said "The rights of the stockholders were fixed, the realization only being postponed; and each stockholder so surrendering his interest is entitled to payment therefor regardless of whether or not he disposed of his holdings of original shares. It was a stock dividend, and when the defendant Post sold his stock he sold it, in commercial parlance, ex-dividend." This judgment was affirmed by the Circuit Court of Appeals, Seventh Circuit, in *Bowers* v. *Post*, 220 Fed. 1006.

In *Shinsaku Nagano* v. *McGrath*, U. S. Court of Appeals, Seventh Circuit, Feb. 26, 1951, 187 F. 2d 753, comment is made on the Uniform Stock Transfer Act, effective in Illinois, and it was held that title to a certificate of stock and to the shares represented thereby could be transferred only by delivery of the certificate properly endorsed or by delivery of the certificate and a separate written assignment or power of attorney.

In the case of *In re Sutherland*, Circuit Court of Appeals, Second Circuit, 23 F. 2d 595, 599, it is said "A stockholder has a vested interest in the corporate profits by virtue of the stock ownership, and when a dividend is declared, and a segregation thereof is made to the amount of the dividends, the amount thereof is held by the corporation as trustee for the stockholder."

In *Southbine* v. *Stroud*, Circuit Court of Appeals, Second Circuit, 5 F. 2d 809, question arose as to the validity of a contract to buy stock of a corporation. The Court held that the contract was made and completed on June 2, 1923, as evidenced by broker's slips and notes though payment was not made until June 5, 1923. It held that dividends which had been declared prior to the making of the contract, if any, would remain the property of the Seller after the performance of the agreement and those

declared by the corporation after the making of the contract on June 2, 1923, would become the property of the purchaser.

The Court, in the case of *Buchanan* v. *National Savings & Trust Co.*, Court of Appeals of District of Columbia, 23 F. 2d 994, stated that it had long been the custom of directors to declare distinctly that the dividend shall be made to stockholders of record on a specified day and that the rule that a dividend belonged to the owner of the shares at the time the dividend was declared did not obtain where at the time the dividend was declared it was made payable to stockholders of record at a future date.

The decision below is contrary to United States Supreme Court decisions and a decision of the United States Court of Appeals, Seventh Circuit, wherein credence is given to conditions precedent as to determination of rights of shareholders. Therefore it should be reviewed.

In *Jones* v. *United States*, 96 U. S. 24, a contract contained a provision that goods must be delivered or tendered on the day specified in the contract. The Court stated "* * * where the right to demand the performance of a certain act depends on the execution by the promisee of a condition precedent or prior act, it is clear that the readiness and offer of the latter to fulfill the condition, and the hindrance of its performance by the promisor, are in law equivalent to the completion of the condition precedent, and will render the promisor liable upon his contract."

Also note *Ware* v. *Allen*, 128 U. S. 590 where a note was held unenforceable because a condition had not been

met. The note contained the condition "Provided we are not defeated in the suit against T. P. Ware."

In the case of *Burke* v. *Dulaney*, 153 U. S. 228, action had been started by the payee of a negotiable note against the maker. The Court held as admissible evidence to show a parol agreement between the parties made at the time of the giving of the note that it should not become operative as a note until the maker could examine the property for which it was to be given. The evidence offered tended to show, Justice Harlan stated "that the written instrument was never, in fact, delivered as a present contract, unconditionally binding upon the obligor * * * but was * * * to become an absolute obligation of the maker in the event of his electing, upon examination or investigation, to take the stipulated interest in the property in question."

The United States Court of Appeals, Seventh Circuit, in the case of *Getz* v. *City of Harvey*, 118 F. 2d 817 interpreted a contract in which it was provided that it was subject to and dependent upon the ability of the defendant to purchase and deliver certain outstanding securities. The Court held that parties had no right of action for breach of contract or to have the Court declare a trust by virtue of conditional contracts which, because of failure of prescribed conditions, never come into effective legal existence.

The decision below is contrary to principles established by income tax ruling and by United States Court of Appeals cases in the Seventh and other circuits for determination of whether or not the purchaser of stock under contract has such complete beneficial ownership to make him liable for income tax on the dividend.

The intention of the parties is the controlling factor. In *Vermont Transit Co. v. Commissioner*, Circuit Court of Appeals, Second Circuit, 218 F. 2d 468, it is stated that this intent may be inferred from the wording of the agreement and from the surrounding circumstances.

In the case of *Northern Trust Company of Chicago* v. *United States*, United States Court of Appeals, Seventh Circuit 193 F. 2d 127, a seller deposited endorsed certificates of stock with a bank in escrow and the buyer deposited installment notes in said escrow. The seller could demand payment of the purchase price and the buyer could demand delivery of the stock to him on payment of the price agreed upon. The Court found that the purchaser was the beneficial owner of the stock entitled to the dividend to be applied on the purchase price.

In Revenue Ruling 56-153, 1956-1, Cum. Bull. 166, the ruling which was requested was in the case in which a sale of stock had been consummated, in which the buyer was unconditionally liable on installment notes, in which, at the time of sale, entries had been made on the books of the corporation indicating transfer of the stock and in which, concurrently with the sale, a collateral trust agreement had been executed. In that case it was provided that dividends be paid out of future earnings quarterly for payment on notes and it was provided that payments (out of dividends) be applied on principal and interest.

In the case of *DeGuire* v. *Higgins*, Circuit Court of Appeals 2d Cir. 159 F. 2d 921 an escrow agreement was made between a seller and a buyer. The seller deposited endorsed certificates of stock and the buyer deposited certain installment notes. The escrowee was instructed to deliver the certificates to the purchaser as the notes were paid. It was provided in said agreement that all

dividends which might be paid during the life of the agreement be credited upon the principal and interest of the next one of the notes thereafter to become due. In this case the Court stated that it was a question of intention.

Also, in *Moore* v. *Commissioner*, United States Court of Appeals, Seventh Circuit, 124 F. 2d 991, the seller deposited endorsed certificates of stock with a bank in escrow and the buyer deposited installment notes in said escrow. There was a positive undertaking to sell upon the one party and a positive undertaking to buy on the other side.

In all these cases to determine which party possessed beneficial ownership at the time of the dividend, the Courts considered rights and circumstances. These rights and circumstances are the right to vote the stock, the right of control over declaration of dividend, the right of control over officers, policies and management of the corporation and the right of the parties to enforce the contract. Consideration is given to whether or not stock certificates were out of the control of the seller before the dividend was declared.

These important questions should be settled by this Court.

CONCLUSION.

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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APPENDIX.

In The
UNITED STATES COURT OF APPEALS
For The Seventh Circuit

September Term, 1956, April Session, 1957

No. 11956
Clarence W. Miller and
Emma L. Miller,
Petitioners,

v.

Commissioner of Internal Revenue,
Respondent.

No. 11957
Commissioner of Internal Revenue,
Petitioner,

v.

Raymond S. Miller and
Josephine Miller,
Respondents.

No. 11958
Commissioner of Internal Revenue,
Petitioner,

v.

Frank Nowatzki and
Lillian Nowatzki,
Respondents.

Petition for Review of Decisions of the Tax Court of the United States.

July 9, 1957

Before Duffy, *Chief Judge*, Major and Finnegan, *Circuit Judges.*

Finnegan, *Circuit Judge.* These multiple appeals arise out of a decision of the tax court, reported as *Miller, et al.*

v. *Commissioner*, 26 T. C. 16 (1956), holding the dividends involved taxable as ordinary income to the seller of the stock of Tiny Tot Safety Table Company, an Illinois Corporation. Deficiencies in income taxes for the year 1950 are involved. That the dividend was taxable to the seller was the chief contention of the Commissioner who, as he asserts through his brief, "being charged with the duty of collecting the revenue is occasionally required to take inconsistent positions in order to conform to his duty. The present consolidated proceeding presents such a problem. The Commissioner believes the Tax Court was correct and would not have appealed in the case of the buyers had not the seller filed a petition for review." In short, we are told this "dividend was inexorably income to someone." Accordingly, the Commissioner filed a protective appeal against the buyers Raymond S. Miller, Josephine Miller, Frank Nowatzki, Lillian Nowatzki when Clarence W. and Emma Miller took their appeals. The Tax Court had sustained the Commissioner's determination of deficiencies against the seller Clarence W. and his wife, Emma Miller, and reversed the Commissioner's action against the buyer, Raymond S. and his wife, Josephine Miller and the other buyer, Frank and Lillian Nowatzki, his wife.

Documentary evidence forms all of the record in this case and since the written agreement between seller and buyer, the corporate resolution and the marginal notation in the minute book are each fully reprinted in the Tax Court's opinion, it is unnecessary to again reproduce them. The short of it is in the Tax Court's view of the exhibits, that the seller was the person in possession of the legal title, to the corporate stock, and held beneficial ownership of the shares at the time of the dividends.

The seller owned 45,500 shares of 46,700 shares of the issued and outstanding capital stock of Tiny Tot Table Company, and he also owned the patent rights to manufacture, use, and sell Tiny Tot Safety Tables and accessories. On July 29, 1950, the seller contracted with buyers for the sale of the stock and patent rights not theretofore

assigned to the corporation. On that same day, July 29, 1950, the directors of Tiny Tot, upon written waiver of notice, held a special meeting for the purpose of considering the sales agreement and declaration of dividends. This meeting was held and the directors, in substance, declared a dividend of 58¢ per share on the 46,700 shares payable August 4, 1950 to stockholders of record on July 28, 1950. By their notation on the last page of that resolution, the buyers approved the action.

Later, on August 4, 1950, the seller made a written assignment of his shares to the buyers. The seller received the declared dividends through two checks dated August 7, 1950 in the amounts of $7,623.97 and $18,766.03. In his 1950 tax return, filed jointly with his wife, the seller reported a net long-term capital gain from the sale of his stock which was disallowed by the Commissioner who treated the amount of dividend as ordinary income. On the other hand when the buyers filed their 1950 returns, jointly with their respective wives, they omitted the dividends which precipitated the Commissioner's notice of deficiency and inclusion of one-half of the dividends in the incomes of each buyer.

Normally income derived from property is attributable to the owner of the income producing item, for income tax purposes. We think consistency of decision in the federal tax field is indispensable for taxpayers and their advisers who need to predict the tax consequences of their transactions. Yet what frequently appears, on cursory examination, as a sport among tax case precedent is actually a permutation spawned by the peculiar facts of some particular case. To be sure, lurking in the volumes of reports there are, often, some bizarre results arising out of judicial struggles for an opinion based on the choice of the taxable person from among several engaged in the transactional shift of income-producing property. The case now before us is a striking example of an instance where view-point and emphasis of this or that fact could change the result for, as we have said, the decision pivots on the meaning extracted from several documents.

Reduced to its lowest terms, the essential facts, expose this problem: B and C, together, executed a sales contract with A to buy from A his shares of stock in T Corporation. The agreement provided for redelivery and reassignment of those shares to A as collateral security for the purchase price payable by B and C. Later on the same day when the contract was signed, T corporation declared a cash dividend payable to stockholders of record on the day preceding. Shortly afterward A formally assigned his stock to B and C, which action was followed by delivery of T corporation's dividend checks to A. Which of the parties A or B and C, received these dividends as ordinary taxable income? Section 22(a), Internal Revenue Code of 1939, 26 U. S. C. § 22 (1952).

According to the Tax Court the incidence of this tax fell upon A and we disagree. Only by reading and interpreting the documentary exhibits, and giving the words their natural meaning, can the choice of the taxable person or persons be made in this case. Beyond dispute B and C were obligated to pay A the purchase price for which they had committed themselves. Each of them (Nowatzki and Miller) approved the declaration of dividends and thereby claimed its benefit. That these dividends were used to reduce the unpaid portion of the purchase price is hardly a forlorn possibility, indeed A's prompt assignment to B and C is consistent with that view we take of the relevant documents. At least we have an objective fact, *i. e.*, payment of dividends to A and his assignment of stock to B and C. *Lee* v. *Commissioner*, 143 F. 2d 4 (7th Cir. 1944). Otherwise the case would be resolved on subjective considerations obscured by the tense of verbs in the contract of sale. We think the buyers are taxable on these dividends because, in the last analysis they were applied on the purchase price. *De Guire* v. *Higgins*, 159 F. 2d 921, 925 (2nd Cir. 1947). On course what we have just held collides with this passage in the Tax Court's opinion:

> " . . . here the seller himself made a formal assignment of the shares to the buyers 6 days after the agreement was executed and the dividend declared. The most plausible inference to be drawn from this,

we think, is that the seller had ownership and control of the shares when the dividend was declared; this being so, the dividend that was declared payable to him (as record owner of the shares on July 28, 1950) and that was actually paid to him, should probably be included in his income in the year received.

The fact that the parties in one part of their agreement included the dividend as part of the purchase price of the shares does not necessarily alter the tax consequences of its payment. In another part of the agreement it was provided that the dividend in question was to be paid to the seller and was to "apply on or reduce said sale price (of the stock) in such amount." This, we think, is the essence of the transaction: The corporation had a substantial earned surplus accumulation at the time; such surplus was available to the then stockholder (the seller); a dividend from the surplus was declared on the same day that the agreement to sell was entered into and while the seller was still in control of the corporation; this dividend was specifically made payable to stockholders of record the day before the date of the agreement (again, the seller); and the dividend was so paid, and according to the agreement, the amount of the dividend reduced the sale price of the stock. On these facts, the dividend was the seller's and was properly taxable to him."

After all A was holding the shares as collateral pending payment of the purchase price. The timing of voting the dividends is equivocal. We are not brushing aside the resolution's clear provision for payment of dividends to stockholders on the day before the dividend was declared but reading it along with the marginal notation of approval by the buyers (B and C). If they were uttter strangers to the ownership of this stock we perceive no sound reason for having them acquiesce on the dividend resolution.

Our earlier decisions, *Moore* v. *Commissioner*, 124 F. 991 (7th Cir. 1941) and *Northern Trust Co. of Chicago* v.

United States, 193 F. 2d 127 (7th Cir. 1952) are consistent with the result we have reached in this appeal. See also: Rev. Rul. 560153, 1956-1 Cum. Bull. 166 following out the capital asset concept for a vendor of stock on which dividends are declared. Because *Hulbert* v. *Commissioner*, 227 F. 2d 399 (7th Cir. 1955), cited to us by the government, involves a partnership we need not further distinguish it.

We hold these dividends were not ordinary income to the seller but were as to the buyers. Accordingly, we reverse the appeals of: Raymond S. Miller and Josephine Miller (No. 11957), and Frank Nowatzki and Lillian Nowatzki (No. 11958) and reinstate the Commissioner's determination of deficiencies against them.

We further hold that Clarence W. and Emma L. Miller received the dividends as part of the proceeds of sale with a consequent capital gain and on this phase of the opinion brought here for review the tax court decision is also reversed.

DUFFY, *Chief Judge*, dissenting.

The dividend in question was declared payable to stockholders of record as of July 28, 1950. Although the agreement is cast in the present tense, an examination of the contract as a whole in view of the surrounding circumstances, convinces me the parties did not intend a present sale.

There was no transfer of legal title to the shares at the time of the agreement. There was no delivery of the shares, constructive or otherwise, to the buyers. There was no transfer of the shares on the books of the company. During the critical period the seller not only retained title to the stock, but possessed full and complete beneficial ownership. I would affirm the decision of the Tax Court.